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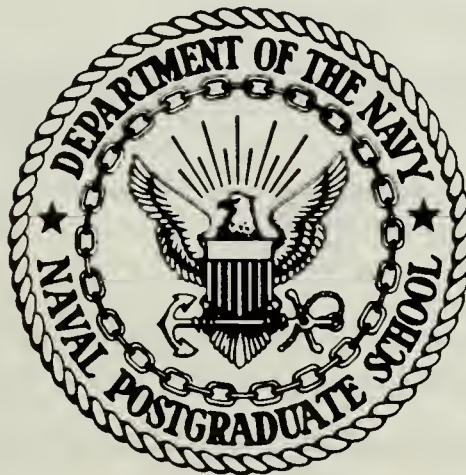
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THESIS

AN ANALYSIS OF UNPRICED ACTIONS
UNDER BASIC ORDERING AGREEMENTS
ESTABLISHED BY THE AVIATION SUPPLY OFFICE

by

Douglas Scott Roark

December 1986

Thesis Advisor:

Raymond W. Smith

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ASO has developed a math model which assists management in the control of UPOs. It takes into consideration the funds available for obligation/inventory replenishment, the required rate of competition and the Navy instituted UPO backlog reduction level.

The researcher has modified the ASO model by adding to the thought process and has reached the conclusion that the manager is not able to make UPO decisions without considering other factors within the acquisition environment. Most importantly, the researcher believes that the decision making process should be decentralized to the acquisition manager and that he should be free to make decisions affecting UPO activity levels and given adequate resources, but at the same time his performance ratings should be predicated on his ability to meet the current definitization timeframes promulgated in the FAR.

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An Analysis of Unpriced Actions
Under Basic Ordering Agreements
Established by the Aviation Supply Office

by

Douglas Scott Roark
Lieutenant, Supply Corps, United States Navy
B.S., Old Dominion University, 1977

Submitted in partial fulfillment of
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

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December 1986

ABSTRACT

This study was undertaken to define the problems associated with the issuance and management of unpriced orders (UPOs) under Basic Ordering Agreements (BOAs) at the Navy Aviation Supply Office (ASO). The researcher attempted to determine the solutions to these problems and develop a model or thought process for acquisition managers to use in the issuance and management of UPOs.

The researcher learned that the issuance of UPOs were interrelated with the requirement to obligate funds in maintaining adequate inventory levels and the enhanced competition goals which resulted from the Competition in Contracting Act of 1984. Driving forces behind the overaged backlog of UPOs were an inadequate workforce, insufficient automated data processing equipment and the inability to enforce the Federal Acquisition Regulation (FAR) definitization requirements. These requirements relate to both the issuance and definitization of UPOs.

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I. INTRODUCTION

A. GENERAL

Unpriced orders (UPOs) are categorized under the broad grouping of unpriced contract actions (UCAs) which also includes letter contracts and unpriced change orders which result from engineering change proposals (ECPs). All three of these contractual actions have something in common, they are normally issued in advance of pricing, hence they are issued unpriced and are priced retrospectively. Since most guidance applies to unpriced contract actions, the researcher will refer to both UCAs and UPOs throughout the thesis. In most instances UPOs are issued with a ceiling price and are later negotiated. This process has been termed definitization and leads to the establishment of a firm fixed priced order.

A basic ordering agreement (BOA) is a bilateral agreement between the government and the contractor which contains appropriate contract terms and conditions. The order under the applicable BOA terms and conditions represents the actual contract. BOAs do not normally specify individual line items, quantities or prices. The UPO order will indicate detail specifications or a statement of work. The BOA can be structured to cover various time lengths, which may include possibly one, two or three years.

BOAs are briefly described in the Federal Acquisition Regulation (FAR), part 16.703 as:

A written instrument of understanding, negotiated between agency, contracting activity, or contracting office and a contractor, that contains (1) terms and clauses applying to future contracts (orders) between the parties during its term, (2) a description, as specific as practicable, of supplies or services to be provided, and (3) methods for pricing, issuing, and delivering future orders under the Basic Ordering Agreement. A Basic Ordering Agreement is not a contract.

The FAR defines BOA applicability by stating that:

A Basic Ordering Agreement may be used to expedite contracting for uncertain requirements or supplies or services when specific items, quantities, and prices are not known at the time the agreement is executed, but a substantial number of requirements for the type of supplies or services covered by the agreement are anticipated to be purchased from the contractor. Under proper circumstances, the use of these procedures can result in economies in ordering parts for equipment support by reducing administrative leadtime, inventory investment, and obsolescence due to design changes.

Additional characteristics include the following:

1. Description of the method to be used in determining contractual prices.
2. Applicable delivery terms and conditions.
3. List of activities authorized to issue orders on DD Form 1155 or Standard Form 26.
4. The appropriate means by which an order is either accepted or rejected.

The BOA will be reviewed each year and any revisions will not be made by modifying the BOA itself in a retrospective fashion. The BOA will be modified by a bilateral agreement between the contractor and the government. The revised BOA will only apply to orders issued after the effective date of

the modification. The BOA cannot be modified by the order. The contracting officer shall follow all other acquisition regulations and laws such as the Competition in Contracting Act (CICA). Prior to issuing an order, the contracting officer must either price the order in advance or issue a ceiling priced order, which limits the government's liability, or he may issue a UFO with no ceiling. The FAR requires that if a ceiling priced order or UFO is issued, the contracting officer must ensure that one of the following conditions is met:

1. The BOA provides for adequate pricing early in the performance of the work; or
2. The need for the supplies or services is compelling and unusually urgent. In this situation, the contracting officer shall price the order as soon as practical.

The Navy Acquisition Regulations Supplement (NARSUP) states that written approval from the Office of the Secretary of the Navy (Contract Business Management) will be obtained prior to the establishment of a BOA that includes provisions for price redetermination. Each BOA will stipulate timeframes for the receipt of contractor proposals which usually fall no later than 60 days after the receipt of the orders. In addition, an agreed upon definitization date will be identified. The NARSUP further stipulates that the definitization date shall not exceed either 180 days following the issuance of the order, or the completion of 40 percent of the work performed by the contractor, whichever occurs first.

B. OBJECTIVES OF THE RESEARCH

The purpose of this study was to reach a better understanding of the use and control of UPOs under BOAs at ASD. Primarily, the researcher attempted to determine the reasons for issuing unpriced orders, associated problems and appropriate management control procedures.

C. RESEARCH QUESTIONS

1. Primary Question:

- a. What are the principal problems in the establishment and management of UPOs under BOAs and how might these problems be resolved?

2. Secondary Questions:

- a. What are the characteristics and principal uses of a UPO under a BOA?
- b. What are the major driving forces behind the requirement for issuing UPOs under BOAs?
- c. What are the problems in the management and control of UPOs under BOAs?
- d. How do we resolve the previously addressed problems?
- e. What model or thought process can acquisition officials use in the management of UPOs?

D. SCOPE, LIMITATIONS AND ASSUMPTIONS

The scope of this study covers the issuance of UPOs at ASD. Due to time and thesis length constraints, the study focuses on the reasons for issuing UPOs and the management control procedures utilized until definitization. The

researcher did not attempt to develop an innovative pricing technique which in turn would help reduce the overdue backlog of UPOs. The study is limited to one Inventory Control Point (ICP) and several item managers. This does not imply that the research findings do not apply to BOAs issued and managed by other Department of Defense (DoD) activities.

It is assumed that the reader has a basic understanding of general supply procedures including ICP objectives concerning spare parts provisioning and procurement.

E. METHODOLOGY

The researcher utilized the services of the Defense Logistics Supply Information Exchange (DLSIE), Defense Technical Information Center (DTIC) and the Federal Legal Information Through Electronics Research Report (FLITE) in attempting to obtain research literature. These searches revealed that there was a limited amount of literature available concerning UPOs. The researcher also utilized DoD and Department of the Navy (DON) instructions, Naval Audit Service Reports and Congressional testimony.

The primary research methodology was the use of personal and telephonic interviews with key personnel at the systems command level, and requirements and purchasing personnel at the field level.

F. SUMMARY OF FINDINGS

The researcher learned that the issuance of UPOs were interrelated with the requirement to obligate funds in maintaining adequate inventory levels and the enhanced competition goals which resulted from the Competition in Contracting Act of 1984. Driving forces behind the overaged backlog of UPOs were an inadequate workforce, insufficient automated data processing equipment and the inability to enforce FAR definitization requirements. These requirements relate to both the issuance and definitization of UPOs.

The inability to definitize in a timely fashion has caught the attention of both the public and Congress. Internally, the Navy has instituted several corrective measures which include: required reductions in UPO backlog, requirements to receive adequate price proposals in advance of issuing UPOs greater than \$1 million and contract clauses which allow the government to stop progress payments to contractors who fail to submit proposals within the required timeframe.

ASO has developed a math model which assists management in the control of UPO issues. It takes into consideration the funds available for obligation/inventory replenishment, the required rate of competition and the Navy instituted UPO backlog reduction level.

The researcher has modified the ASO model by adding to the thought process and has reached the conclusion that the manager is not able to make UPO decisions without considering other factors within the acquisition environment. Most importantly, the researcher believes that the decision making process should be decentralized to the acquisition manager and that he should be free to make decisions affecting UPO activity levels and given adequate resources, but at the same time his performance rating should be predicated on his ability to meet the current definitization timeframes promulgated in the FAR.

G. ORGANIZATION OF THE STUDY

The study is broken down into four chapters. Chapter I, the Introduction, attempts to explain to the reader what research concerning UPOs orders was done and how it was accomplished and the associated significance of the findings. Chapter II, the Framework and Background chapter explains to the reader how BOAs and UPOs are utilized and also provides history and background information. The Framework and Background chapter describes recent Navy Audit Service findings, Congressional testimony given by the Secretary of the Navy, current Navy/ASO policy, future DON plans and possible Congressional intervention. Chapter III, Presentation of Data and Data Analysis/Interpretation, provides in a combined format both presentation of data

collected during the research and a data analysis and interpretation. The researcher did this in an attempt to provide a more concise and coherent thesis. Chapter IV, Conclusions/Recommendations, contains the conclusions to the research effort. Additional areas of research for follow on work are provided.

II. FRAMEWORK AND BACKGROUND

The use of BOAs represents a method of contracting which was introduced to alleviate the administrative burden placed on contracting personnel. BOAs were issued on a yearly basis to sole-source contractors who normally provided repair parts to the government on a repetitive basis. The order which is issued against the BOA contains specific information concerning requirements. An unlimited number of orders can be placed against a BOA. This results in a shorter procurement administrative lead time (PALT) and less contractual documentation than the same number of non-BOA contracts being issued. The BOA was introduced to help streamline the acquisition process and to help government acquisition managers meet fleet requirements more efficiently. [Ref. 1]

A Naval Audit Service report dated 16 December 1985 at the Navy Plant Representative Offices (NAVPROs) in Lynn, Massachusetts; Stafford, Connecticut; St. Louis, Missouri; and Bethpage, New York revealed the following:

Undefinitized orders authorize a contractor to start work before a price has been set. The procurement regulations that allow for undefinitized orders require that prices be negotiated within 180 days after issuance of an undefinitized order or by the time 40 percent of the work is completed, whichever occurs first. Undefinitized orders are usually placed by procuring activities such as the Naval Air Systems Command (NAVAIR) and the Navy Aviation Supply Office (NASO) via procurement instruments known as Basic Ordering Agreements (BOAs). Each order placed under a BOA constitutes a separate contract and in most cases the resident Naval Plant Representative Office (NAVPRO) is required to negotiate the price of the order.

The report continues in its description by stating:

The audit disclosed that the backlogs of undefinitized orders at the NAVPROs audited grew 55 percent between 30 September 1982 and 30 June 1985, the backlogs at these NAVPROs totaled 4,760 orders valued at about \$3.06 billion. About \$2.12 billion of these orders had remained undefinitized longer than the 180 days allowed by a Navy regulation. About \$63.4 million in orders in an audit sample of \$188 million remained undefinitized even though work was 80 to 100 percent complete.

As a result of late pricing, the Government was placed at a disadvantage in negotiating prices; the contractor's incentive to control costs was diminished; there was a risk of entering a prohibited cost-plus-percentage-of-cost contracting mode; an estimated \$699 million remained obligated unnecessarily on the basis of excessively high pre-negotiation cost estimates; and the Navy could be denied the use of an estimated \$217 million in excessively obligated funds when the related appropriations expired. We also found that the orders were priced after reaching a near-completion stage, an average 11-percent profit was allowed. We concluded that profit on such orders should be limited to no more than 8 percent, and estimated that if NAVPROs continued to award profits at an 11-percent rate, about \$18.9 million in excess profits would be awarded as the 30 June 1985 backlog was worked off. [Ref. 2:p. 1]

Mr. E.G. Cammack, the Director of Contracts and Business Management, Office of the Assistant Secretary of the Navy (Shipbuilding and Logistics) (ASN (S&L)) issued a memorandum dated 23 October 1985 which concerns undefinitized contractual actions. The memorandum included a draft policy directive for undefinitized contractual actions and requested comments from all systems command headquarters. A copy is provided as Attachment (B). Policy highlights include:

1. The reduction in the number and dollar value of unpriced orders issued in FY86 by 25 percent compared to FY85.

2. The requirement for the receipt of an adequately prepared and supported proposal prior to the issuance of a UPO in excess of \$1 million. Any exceptions to be approved by the Head of Contracting Agency (HCA).
3. The provision for withholding progress payments on contracts where proposals are delinquent.
4. The use of statistical pricing techniques for spare parts excluding tools, accommodation equipment and items considered susceptible to overpricing.
5. The inclusion of UPO performance definitization as a key Command indicator.
6. The negotiation of profit rates which are reflective of the risk associated with the manufacturing process at the time of definitization.
7. The prohibition of UPO use for any service or requirement which cannot be clearly defined.
8. The prohibition of adding additional requirements to existing orders.

ASO sent a memo titled, "Input for Discussion with ASN (S&L) Re: Undefined BOA Orders" to The Naval Supply Systems Command (NAVSUPSYSCOM). The memorandum is included as Attachment (C). ASO stated that BOAs served as effective administrative tools to promptly place on order the requirements for aviation spare parts and the repair of repairables. ASO recognizes that the problem stems from the perception that UPOs are definitized late and that negotiations result in excess profits to the contractor. In addition, ASO made the following recommendations:

1. The backlog of UPOs should be stratified by the contractor and by the administrative phase of definitization.

2. Increase the use of correspondence with contractor personnel from the Director of Purchasing.
3. Initiate the use of tiger teams to facilitate negotiations.
4. Expedite business clearance processing.
5. Expand the use of Forward-Priced Rate Agreements (FPRA).

On 4 November 1985, Secretary Pyatt, ASN (S&L), issued guidance concerning UCAs. The memorandum is included as Appendix (D). Secretary Pyatt indicates that UCAs have been used primarily to satisfy fleet requirements, maintain obligation plans and meet program schedules. Secretary Pyatt states that UCAs do not achieve cost control and directed the following actions:

1. Reduce the number of UCAs issued in FY86 by 20 percent and the outstanding dollar value by 30 percent compared to the end of FY85.
2. Review UCAs for possible deobligation of funds.
3. Require the receipt of an adequate price proposal prior to the issuance of a UCA in excess of \$1 million. Any exceptions to be approved at flag/senior executive service levels.
4. Require that contractors propose and segregate costs by order.
5. Include a contract provision for the withholding of progress payments for delinquent proposal submission.
6. Disallow the inclusion of additional requirements to existing orders.
7. Prohibit the use of UPOs for contractor support services or in other instances where requirements cannot be adequately defined.

8. Include UCA definitization performance as a key Command indicator.
9. Negotiate profit rates commensurate with the level of the risk experienced by the contractor at the time of definitization.

The researcher believes that the guidance provided in the final format (Attachment (D)) closely resembles the rough draft (Attachment (B)). Further guidance from Secretary Pyatt was provided in a memorandum dated 26 February 1986. The memorandum is provided as Appendix (E). It mentions that the major reason that UCAs go past the scheduled definitization dates is because of the submission of inadequate proposals or the late submission of proposals. He also states that in these instances the contractor continues to be funded through progress payments. Secretary Pyatt's major point is "when the contractor is delinquent in submitting definitization proposals, you should withhold progress payments." [Ref. 3]

To meet Secretary Pyatt's goals, the Operation and Policy (OP) Branch of ASD issued a memorandum dated 18 December 1985. The memorandum is included as Appendix (F). It acknowledges that historically, 70 percent of ASD's obligations have been made by use of the BOA and instructs item managers to increase administrative leadtimes (ALTs) to a minimum of 90 days and up to 270 days for sole source procurements. Item managers were directed to ensure that items with an ALT of less than three quarters be increased

to three quarters. In addition, OP issued a memorandum dated 22 April 1986 which laid the framework to meet Secretary Pyatt's goals. The memorandum is provided as Attachment (G). ASD estimated that the UPO level could not exceed \$1.9 billion dollars as of 30 September 1986. The beginning balance as of 1 April 1986 was \$2.6 billion. It was planned that issues of UPOs would be limited to \$100 million per month with no UPOs issued in September. It also provided that UPOs would be definitized at the rate of \$200 million per month. The future awards of UPOs were to be prioritized as follows:

1. FY86 repair of repairables.
2. Purchase requests (PRs) greater than \$100K with a projected stock-out rate within 12 months. (Commanding Officer approval required if over \$1 million.)
3. PRs greater than \$100K with a projected stock-out rate within 18 months. (Commanding Officer approval required if over \$1 million.)
4. Emergency PRs between \$25,000 and \$100,000.
5. Other PRs.

Recently, Representative Wyden introduced a bill that would severely limit the use of UCAs. A 24 March 1986 issue of The Wall Street Journal indicated that Representative Wyden wants to limit the use of UCAs to "urgent needs" but a review of the proposed legislation indicates that by FY87, UCAs will be limited to 10 percent of the amount of funds appropriated for defense procurement. It also stipulates

that the percentage is to be decreased to 5 percent for FY88 and FY89. The proposed legislation is provided as Appendix (H).

Most recently, Secretary Pyatt issued a memorandum which indicates that he is contemplating to establish an even more "aggressive goal" for FY87 as compared to the goals he established for FY86. The goal is tentatively based on a 50 percent reduction in dollar backlog compared to FY86.

[Ref. 4]

III. PRESENTATION OF DATA AND DATA ANALYSIS AND INTERPRETATION

The purpose of this chapter is twofold. First the researcher will present data which relates to the secondary research questions. Most of the data was obtained either through personal interviews or from telephone conversations. The second purpose of this chapter is to provide the appropriate data analysis and interpretation. The researcher decided that this combined format would result in less repetition and better clarity and understanding of both the information and interpretation.

A. CHARACTERISTICS AND PRINCIPLE USES OF A UPO UNDER A BOA

The researcher received a wide variety of replies when he asked interviewees to define the characteristics and principle uses of UPOs under BOAs. Some of the following were provided:

1. UPOs under BOAs were originally intended to be used only in emergent situations. An example would be the procurement of a spare part that was not held in inventory and that was required to correct a Casualty Report (CASREP) for surface fleet equipment or a Non Mission Capable System (NMCS) for aviation end items. [Ref. 5]
2. A source who requested anonymity stated that, "BOAs were established to ensure adequate inventory protection. Normal contracting methods were utilized to replenish inventory levels but due to uncertain demand requirements, stock-outs occasionally occurred and BOAs were used to bypass the Procurement Administrative Lead Times (PALTs)."

3. BOAs were made available to the acquisition manager in an effort to cut down on the administrative burden. With an increased amount of required contractual documentation and a workforce that trailed this increased demand in both numbers of personnel and training qualifications, BOAs proved to be of great value. BOAs were established for items that were tied to a sole source producer. BOAs were broadly written which allowed greater flexibility to both the government and the contractor. [Ref. 1]

Due to the wide variety of views concerning the prerequisite conditions for the use of UPOs under BOAs, the researcher believes that it is best to refer to the FAR and NARSUP, part 16.703, quoted in the Introduction.

It is a commonly held belief that UPOs are not being priced within the required timeframe of 180 days after receipt of order or at the 40 percent completion point, whichever occurs first. A Naval Audit Service report indicated that approximately 64 percent of the orders in the backlog at the NAVPROs were older than 180 days as of 30 June 1985. The Naval Audit Service selected a sample of 25 orders at each NAVPRO and determined that it took an average of 232 days to submit cost proposals to the government and that the average total time to definitize the orders was 633 days. [Ref. 2:p. 6]

As of September 1985, DoD had almost \$27 billion in UCAs. In November 1985, the Office of the Secretary of Defense directed each of the services to develop goals to reduce the volume of UCAs. The U.S. House of Representatives Committee on Armed Services held a hearing on 18 March 1986 for testimony concerning UCAs from each service secretary.

Congressional concern over the enormous amount of UCAs included:

1. The possibility of the government being placed in an unfavorable negotiation position.
2. The cost risk that was shifted from the contractor to the government.
3. Reduction of contractor incentive to control costs. [Ref. 6]

During his testimony, Secretary Pyatt referenced the Naval Audit Service report which was previously mentioned and he acknowledged that the UCA backlog was growing and that negotiated profits exceeded the appropriate risk experienced by the contractor. Obligations were considered excessive but the government's liability was limited by the use of clauses and ceiling prices.

Secretary Pyatt stated the following policy:

1. The number of UCAs in FY86 were to be limited to 80 percent of the FY85 level.
2. The backlog of \$10.6 billion was to be reduced to \$7.2 billion by the end of FY85.
3. Excess funds on existing UCAs were to be deobligated.
4. Adequate price proposals were to be received prior to the issuance of a UFO in excess of \$1 million.
5. Provisions for the withholding of progress payments for delinquent proposals were to be included as a contract provision.

Secretary Pyatt explained that the increased backlog was caused by the change in pricing methodology. Because of cases of overpricing, contracting officers may have shifted

away from statistical sampling techniques to precise line item pricing. [Ref. 7:pp. 1-3]

B. THE MAJOR DRIVING FORCES BEHIND THE REQUIREMENT FOR ISSUING UPOS UNDER BOAS

Most readers would normally consider this an easy task to define but the researcher found it difficult to explain. Like many other Navy procurement activities, ASO did not have an effective automated management information system (MIS) for tracking the timing of the flow process for a UPO from generation to definitization.

Many interviewees agreed that UPOs allowed ASO and other DoD activities to meet the fleet's requirements, maintain required obligation rates and sustain required inventory levels. [Refs. 1,5,8] This has been especially apparent during times where managers considered themselves either undermanned or manned with untrained personnel. This brings to light the third interviewee response discussed during the previous secondary question which basically states that BOAs and UPOs were introduced in an attempt to eliminate a major portion of the administrative burden placed on the procurement manager.

Use of the BOA has enabled ASO to effectively obligate funds. Throughout the thesis, the term "obligation rate" refers to a "macro" measure of effectiveness used by ASO

in replenishing a constantly depleting inventory. ASO uses the Uniform Inventory Control Point (UICP) replenishment model to trigger the start of the procurement process. The model takes into consideration many variables in determining the reorder quantity and reorder point. The reorder quantity refers to how much to order while the reorder point refers to when to order. The variables include, but are not limited to, the mean administrative leadtime (ALT), mean production leadtimes, mean quarterly demand, associated variances, item cost, holding costs, and administrative ordering costs. Funding is made available through the use of the Navy Stock Fund (NSF) account. NSF differs from traditional procurement funding in that it is based on a pool of funds that is recycled and never expires.

These variables are input into a program termed the supply demand review (SDR) which is periodically run to trigger the initiation of the procurement process. Funding is a limiting factor and since ASO, like other DoD activities, is sometimes faced with inadequate or unstable funding levels, the model is appropriately adjusted. This results in unstable inventory levels. As funding decreases, the inventory level decreases.

An additional driving force is the increased use of competitive procurement in the acquisition of spare parts. At first glance, the reader would think that competition and

BOAs were inversely related, as you acquired more items through competition you would need to procure less through the use of BOAs.

The researcher will attempt to explain why this is not entirely true. Congressional concern about DoD being overcharged for supplies obtained from sole source producers was the catalyst for the Competition in Contracting Act (CICA) which took effect in April 1984. The end result of CICA was the establishment of competition goals which were gradually increased each year. These goals were imposed on all DoD buying activities. Competition can be closely tied with the Buy Our Spares Smart (BOSS) program, specification streamlining and spares breakout. Competition is considered a driving factor for BOA use primarily for two reasons.

The major reason why competition has been a driving force behind the use of BOAs deals with first time competitive buys. When an item is considered eligible for competitive procurement, a large amount of time is expended in developing a sound Invitation For Bid (IFB) or Request For Proposal (RFP). The buyer goes through a learning process, thus it will take less time to process the second or third procurement of the item. Since it is hard to plan the breakout of spare parts and since first time competitive procurements take a considerable amount of time, BOAs are ideal in acquiring "stop gap material" which is intended to

prevent material stock-out prior to the receipt of material competitively procured. ASD has received additional manpower resources to assist in meeting competition goals and BOSS initiatives but no additional resources were allocated toward reducing the overaged backlog of UPOs. An additional factor is the shift from retrospective pricing to prospective pricing which results in longer ALT. Stop gap material can easily be obtained through the use of a UPO. This exemplifies an earlier premise that BOAs assist in helping the procurement manager relieve himself of some of the administrative burden. BOAs save time in the procurement of non-competitive items and allow this time to be expended toward the attainment of competition goals. [Ref. 9]

C. PROBLEMS IN THE MANAGEMENT AND CONTROL OF UPOs UNDER BOAs

It is very apparent that there are Navy-wide problems in the management and control of UPOs under BOAs. This is clearly evident for two reasons. The first is that a major portion of the backlog is aged or greater than the maximum specified time frame of 180 days or 40 percent of completion. The second is the increased amount of congressional concern as indicated by Representative Wyden (D-Oregon) who introduced a bill to limit the use of UCAs.

As mentioned earlier, ASD did not have an effective automated MIS system to track the procurement process which would lead to a clear understanding of where bottlenecks

occur. An on site review by the researcher revealed that the current BOA process can be characterized as mostly manual with numerous preaward actions. Limited human and automated data processing (ADP) resources have further exacerbated management's inability to internally monitor the process.

External reports include the DD Form 1057, Monthly Procurement Summary of Actions \$25,000 or less and the DD Form 350, Individual Contract Action Report (over \$25,000). The DD 1057 is submitted monthly and is a summary of contractual actions under \$25,000 while the DD 350 is submitted and revised for individual contractual actions greater than \$25,000 when different milestones are reached. An initial problem experienced was that DD 350s were tracked only for acquisitions made for the current year. This created an unusable reporting system since definitization periods normally extended between different years. The reporting system has been changed to allow the tracking of procurements over different years.

On the government's side, the standard explanation for excess definitization periods was the late submission of an adequate cost proposal or amplifying data. An additional reason was the inability to receive timely recommendations from the administrative contracting officer and the Defense Contract Audit Agency.

On the other hand, contractors felt that they took due diligence in providing supportable cost proposals. When asked to speak freely on a non-attribute basis, one contractor stated, "We do not take the required 180 day or 40 percent complete definitization requirement that seriously since the government tends to place the definitization of UFOs on the "back burners" as compared to other upfront pricing actions."

Most importantly, it was agreed to by both the government and the contractor that there was some fault attributable to both parties.

One of the biggest problems experienced by ASO was previously mentioned as a driving factor. Specifically this problem deals with the interrelationship between the available amount of funds to obligate in maintaining adequate inventory levels, the required percentage of competitive awards and the ability to use a UFO as opposed to a prospectively priced order. ASO describes this interrelationship as a triumverate with the three factors being obligations/readiness, unpriced orders and competition. It has been a well-known fact that DoD has had a difficult time in fully supporting all existing weapon systems. The explanation for this situation is beyond the scope of this thesis but funding constraints seem to be a limiting factor. It was not evident that ASO wastefully obligated funds or had any reason to wastefully obligate them for unnecessary items

since ASD uses NSF and is in the business of supporting someone else's, namely the fleet's, requirements. [Ref. 8]

In most circumstances, ASD personnel may use the following contracting methods to acquire repair parts:

1. Competition.
2. Sole source negotiation.
3. Prospectively priced order under BOA.
4. UPO under BOA.

CICA and BOSS have resulted in the increased use of competition. Most acquisition managers feel that competition is the preferred method of contracting but they also agree that the initial use of competition requires additional effort. The Navy's Competition Advocate required that DON activities attain competition goals. ASD has been tasked to achieve the following competition goals:

FY 85 29 percent

FY 86 40 percent

FY 87 42 percent

It should be mentioned that BOAs may be used for competitive procurements. If a contractor successfully negotiates a fair and reasonable contract price through the competitive proposal process, an order may be issued to contract for the requirements if a BOA currently exists with the appropriate terms and conditions. [Ref. 5] The additional time required for initial and succeeding

competitive procurements causes a corresponding decrease in the time available for the other three methods of contracting.

The recommendation of Secretary Pyatt to "negotiate provisions in new BOAs and orders to withhold progress payments where history of delinquent proposal submission exists" attracts the concern of both government and industry personnel. This would require a bilateral agreement of both parties and some consider the withholding of progress payments to be punitive which the procurement regulations disallow. In addition, this requirement would be very difficult to enforce unless the government could prove that it was completely free of fault. The additional administrative burden must also be considered prior to the use of this measure.

Congress holds the belief that contractors receive too high of a profit considering the risk involved. This stems from the fact that BOAs are normally definitized well into contract performance when the contractor should have a reasonable handle on costs. [Ref. 6]

An additional problem is experienced by the PROs. ASO definitizes approximately 70 percent of UPOs and delegates the definitization for the remaining UPOs to the PROs. The PROs have an extremely difficult time trying to effectively manage their work when they have no idea of what work requirements will flow down to them. [Ref. 5]

It must be remembered that the use of UPOs cannot be completely banned due to the need to contract for the repair of Depot Level Repairables (DLRs) and to satisfy emergent requirements. In some instances the repair of DLRs can be carried out by the use of two different orders. The first order would be prospectively priced for open and inspection (O&I) effort. After O&I, the contractor would then submit a cost proposal to the government which would allow the negotiation of a prospectively priced order. However, the use of a UPO may still be more feasible because the method described above requires prospective agreement on O&I charges for all DLRs and the use of two contractual actions to perform the same task performed by a single UPO.

BOAs also serve as a quick means to satisfy emergent requirements. For these reasons, the removal of the UPO from one of the methods of contracting is not considered feasible.

D. METHODS TO RESOLVE PROBLEMS ASSOCIATED WITH UPOs

ASO has implemented two different programs which should assist in properly determining the timeframes associated with the PALT process. These programs include bar code technology and a BOA Liquidation Tracking System (BLT). The procurement process at ASO can be closely associated with other activities such as Navy Regional Contracting Centers and Naval Supply Centers. The process can be described as mostly non-automated. Taking a tour through the BOA buying

division, one would first notice the enormous number of folders which correspond to individual procurement requests (PRs). To assist the tracking of the PRs through the individual procurement phases, ASD has placed bar code labels on the individual folders. A wand, similar to those found at many department stores, is used to read the bar codes as the PR travels through each procurement phase.

The BLT system is designed as a computerized milestone monitoring system to track the progress of BOA related PRs greater than \$25,000 from receipt until the final DD 350 has been submitted. The BLT input form contains 14 different pricing action milestones. [Ref. 10]

NAVSUPSYSCOM has introduced the Productive Unit Resourcing System (PURS) which should help ASD improve in the area of human resources. PURS covers procurement operations, contract administration and contract pricing functions. Basically, it provides for the establishment of labor costs per productive unit. NAVSUPSYSCOM provides standard manhours and productive units associated with different pricing actions. For example, placing an order under a BOA is given 13 standard hours or one productive unit while establishing the BOA itself is worth 26 standard hours or two productive units. Prior to the start of each year, NAVSUPSYSCOM negotiates rates with each procuring activity. Negotiations consider past performance and projected workload. During performance, if ASD achieves a better rate, then it shares

with NAVSUPSYSCOM in the savings. Some managers are concerned that cyclic fluctuations may cause an unstable workforce where personnel will be hired and layed off according to the workload. Accordingly, they request that the periods be annual or semiannual periods instead of quarterly or monthly. In addition, the removal of personnel ceilings as of 1 October 1986 will allow management greater flexibility in designing the ideal workforce. For example, when a GS-13 transfers, management can either hire a replacement GS-13 or hire two lower paid GS-7s. [Ref. 11]

Secretary Pyatt's requirement to receive an adequate cost proposal prior to issuing a UPO in excess of \$1 million should speed up the definitization process. Many agree that this method is preferred to stopping progress payments for contractors who are delinquent in the submission of a cost proposal.

In the area of excess profits, ASD contends that contracting officers are negotiating profit commensurate with the risk involved. In addition, Contract Review Board (CRB) procedures presently provide for the proper review of all cost elements.

ASD is currently in the process of reviewing all existing UPOs through the use of the BLT system and deobligating funds if the obligated amount is determined to be in excess.

E. MODEL OR THOUGHT PROCESS AVAILABLE TO ACQUISITION
OFFICIALS IN THE MANAGEMENT AND CONTROL OF UNPRICED ORDERS

All interviewees agreed that the use of UPOs should be internally managed by each service and not by Congress. Some outsiders to the procurement process at ASD believe that UPOs can be done away with but as previously explained, there is not a suitable contracting method available to replace UPOs, in some unique applications.

The most feasible solution offered was to allow the free and open use of UPOs with the only stipulation being that the definitization requirements be enforced. In essence, this allows an activity to issue as many UPOs as it desires as long as the activity meets the definitization requirements. In periods when the requirements are not met, the activity must cease issuing UPOs until overaged UPOs are priced. A less stringent proposal operates in the same basic fashion but allows for a small number of overaged UPOs. Most interviewees agreed that Secretary Pyatt was correct in stressing the importance of UPO pricing performance as a key Command indicator. [Ref. 1]

As mentioned previously, UPOs cannot be managed in a vacuum. Both obligations/inventory levels and competition must be considered. In meeting Secretary Pyatt's required reduction in UPO backlog and competition goals, ASD uses the following mathematical computation:

	Year Long Obligation Goal	
Less:	<u>Obligations to Date</u>	
Equals:	Future Obligations	
Less:	Projected Military Interservice Procurement Requests (MIPRs) and Request for Contract Procurements (RCPs) to be sent outside ASO	
Add:	<u>Projected MIPRs/RCPs to be received by ASO</u>	
Equals:	Balance to Go	
Add:	Base Award Amount (consists of obligations to date, less: MIPRs/RCPs sent out, and add: MIPRs/RCPs received)	
Equals:	Total Projected Competition Base	[Ref. 8]

Then the total projected competition base is multiplied by the required competition goal (40 percent for FY86) to determine the amount of funds which must be competitively obligated for the remainder of the year. The actual competitive award dollars are then subtracted from this year long amount to determine the amount which must be competitively obligated in the remaining months. This amount would be subtracted from the "Balance to Go" to determine the amount of funds that can be obligated in a non-competitive manner. These amounts can either be obligated in a prospectively priced or retrospectively priced fashion.

At this point ASO then determines the amount of funds which can be obligated by UPOs and still meet the required reduction in backlog goals. First, the end of the year goal must be determined. This was determined by reducing the backlog level experienced during prior fiscal year 1985 by 30 percent. This is the amount which ASO must not exceed by

the end of fiscal year 1986. The following computations are then made:

	Beginning UPO Balance	
Add:	UPO Issued to Date	
Less:	<u>Definitizations to Date</u>	
Equals:	Current UPO Balance	
Less:	<u>Projected Definitizations</u>	
Equals:	Ending UPO Balance Without Issues	
Less:	<u>End of the Year Goal</u>	
Equals:	Funds Available that can be Obligated by UPO	[Ref. 8]

The "Funds Available that can be Obligated by UPO" can now be subtracted from the previously computed funds that can be obligated in a non-competitive manner to determine the amount of funds that can be non-competitively obligated but in a prospectively priced fashion.

It is clearly evident that the procurement manager is faced with a myriad of requirements which are interrelated.

The suggestion of an additional method of control seems to be a very effective measure. It was recommended that for UPOs less than \$1 million, progress payments can be better used to motivate contractors to submit adequate price proposals in a timely fashion. The BOA could be modified to reflect the stipulation that for non-emergent requirements under \$1 million, the contractor would be allowed to obligate funds and receive compensation through the Progress Payments clause for only long leadtime material. After the government receives an adequate price proposal, the contractor would then be allowed to obligate funds and seek reimbursement for

expenses other than long leadtime material. Emergent requirements would not be affected by this clause. This recommendation would allow the obligation of funds by the government and motivate the contractor to submit proposals in a timely fashion. Overall, the use of the UFO will shorten the ALT process and this requirement will reduce the definitization period. [Ref. 5]

IV. CONCLUSIONS/RECOMMENDATIONS

The researcher attempted to answer the following primary research question: What are the principle problems in the establishment and management of UPOs under BOAs and how might these problems be resolved?

Analysis of the data obtained strongly indicates that several problems exist.

UPOs as a rule are not being definitized within the timeframes required by the FAR. There are two major reasons for the late definitization of UPOs. The longest standing reason is the inadequacy of both human and ADP resources provided to the procurement manager. BOAs were originally provided to the procurement manager in an attempt to lessen some of the administrative burden which precluded the effective and efficient acquisition of defense material. The second and most recent reason was the enactment of the CICA of 1984. This act was the catalyst for an increased use of competition. Each activity has been tasked with meeting directed competition goals. These goals have been described as being very optimistic. The increased use of competition and the definitization of the overaged backlog requires additional resources. The use of UPOs has enabled procurement managers to meet aggressive competition goals while at the same time meeting obligation rates and maintaining required inventory levels.

UCAs have gained increased Congressional and public interest due to the general nature of the items procured. The overpricing of some spare/repair parts has focused attention to all associated areas including the method of contracting.

In part, Congressional awareness has been the cause for some of the solutions to the UPO problems. In particular, each service has provided testimony to Congress stating their respective plans to reduce the level of backlog. Secretary Pyatt has introduced numerous actions which should alleviate the backlog problem. The increased awareness up and down the chain of command will improve the UPO process. Most important is the required UPO backlog reduction goals and the requirement to receive adequate price proposals prior to the issuance of a UPO in excess of \$1 million.

In the area of personnel resources, the acquisition manager should receive assistance through the introduction of PURS.

It is strongly felt that the Navy can correct any existing UPO problems without Congressional reform. Representative Wyden's bill as introduced is considered to be very restrictive and unnecessary. The bill, which will ultimately reduce the level of UCA activity to 5 percent of the funds available for obligation, may cause greater potential pricing problems. The inability for contracting

managers to use UPOs does not necessarily mean that the government will receive a better contract price. Contractors may have a negotiation advantage if the government is required to prospectively price all orders and meet emergent requirements.

To a certain degree, any required competition goals will control the level of UPO activity. The Navy's self-imposed UPO backlog reduction goals will bring the backlog down to a manageable level. The best method of control is to decentralize the decision-making authority down to the acquisition manager and enforce the FAR definitization requirements by making definitization performance a key Command indicator.

In summary, the ability to choose the level of UPO activity should be left to the acquisition manager as long as the definitization requirements are met. The mathematical model offered by ASD should be combined with the following recommendation by LCDR R.W. Smith and the requirement established by Secretary Pyatt:

1. For non-emergent UPOs under \$1 million, require that contractors expend funds for only long leadtime material until the submission of an adequate price proposal. The BOA would be modified to reflect this requirement and the Progress Payments clause would serve as a control mechanism.
2. Require the submission of an adequate price proposal prior to the issuance of a UPO greater than \$1 million.

An area of further research would be the study or the comparison between the prospective and retrospective pricing

of spares. Of interest would be the determination of which method would lead to the fairest and most reasonable price to both the contractor and the government in the pricing of spare parts.

APPENDIX (A)

DEFINITIONS/ABBREVIATIONS

BASIC ORDERING AGREEMENTS (BOAs) - A contractual document which allows for the purchase of supplies. Individual orders may be placed against the BOA which contains the appropriate terms and conditions.

CEILING PRICE - Applicable to undefinitized contract actions which are retrospectively priced. The ceiling price is an amount which limits the government's liability. The ceiling price may also be considered a not to exceed amount normally based on either a government estimate or the contractor's estimate.

FEDERAL ACQUISITION REGULATION (FAR) - A codification of federal acquisition regulations governing both DoD and non-DoD activities.

UNDEFINITIZED CONTRACT ACTIONS (UCAs) - A family of unpriced/ceiling priced actions which include letter contracts, unpriced orders under BOAs, engineering change proposals.

UNPRICED PURCHASE ORDERS (UPOs) - Unpriced/ceiling priced orders under Basic Ordering Agreements.

OCT 23

Subj: UNDEFINITIZED CONTRACTUAL ACTIONS

Encl: (1) DRAFT POLICY ON UNDEFINITIZED CONTRACTUAL ACTIONS

The Navy has a significant and growing backlog of undefinitized and contractual actions. An increasing percentage of the actions are not being priced in a timely manner. These actions include ceiling priced orders, letter contracts, change orders and long lead amendments. The ceiling priced orders have the fewest controls and the highest rate of growth.

Enclosure (1) is being proposed as a policy directive on the issue. Your comments are requested by 29 October 1985. The CMAS POC is Capt W. R. Morris, SC, USN, (X23329).

E. G. CAMIACK
Director for Contracts
and Business Management

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WRITER: CAPT MORRIS 023
TYPIST: W. CLIMENHAGA, 22 Oct 1985
DOCUMENT TITLE: UNDEFINITIZED CONTRACTUAL ACT

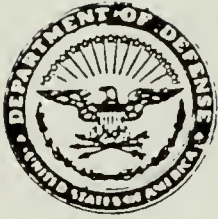
MEMORANDUM FOR DISTRIBUTION

Subj: UNDEFINITIZED CONTRACTUAL ACTIONS

Current data indicates the Navy has backlog of 11,762 unpriced actions valued in excess of 9.5 billion dollars. Over 50% of the dollars are overaged, in excess of 5 months old. Both the size and age of the backlog are of concern. Navy policy is to price in advance whenever possible. The continuing growth of both the backlog of unpriced actions and their age supports the need for additional management emphasis.

Effective immediately, I am directing the following actions:

1. Systems Commands and Inventory Control Points are to reduce the number and dollar value of unpriced/ceiling priced orders issued in FY-86 by 25% compared to FY-85.
2. Contractor proposals are to be requested and determined sufficient for negotiations prior to issuing any unpriced/ceiling priced order projected in excess of \$1 million dollars. Orders are not to be severed to avoid this requirement. Exceptions must be documented and approved by the head of the contracting activity (HCA).
3. Provisions for the withholding of progress payments where contractor proposals are delinquent should be negotiated in new contracts, BOAs and orders where possible.
4. The use of statistical pricing techniques is authorized for spare parts, excluding tools, accommodation equipment and items considered by contracting officers to be most susceptible to overpricing.
5. The backlog and age of undefinitized contractual actions should be considered a Command key indicator, placing management emphasis and visibility on the problem.
6. Profit rates negotiated in the definitization of unpriced orders must reflect the risk or lack of risk associated with the manufacturing process at the time the order is being priced.
7. Unpriced/ceiling priced orders are not to be used for services or in any case where the requirement is not clearly defined.
8. Subsequent to their issue, additional requirements shall not be added to existing orders.



DEPARTMENT OF THE NAVY

AVIATION SUPPLY OFFICE
700 ROBBINS AVENUE
PHILADELPHIA, PA. 19111

IN REPLY REFER TO
PG-A:JRB
4200

15 OCT 1985

From: Commanding Officer, Navy Aviation Supply Office
To: Commander, Naval Supply Systems Command (SUP 02)

Subj: INPUT FOR DISCUSSION WITH ASN(S&L) RE UNDEFINITIZED BOA ORDERS

1. Background. Basic Ordering Agreements (BOA) and ceiling priced/monetary limitation orders thereunder have been used by ASO as an effective administrative tool to promptly place on order requirements for aviation spare parts and repair of repairables. The use of this tool allows ASO to maximize material readiness and minimize inventory investment by reducing procurement administrative lead times. Final pricing of orders is effected after careful review of DCAA/ACO audits, detailed analysis of relevant facts, and detailed negotiations with the contractor. This process permits the Contracting Officer to make a reasoned determination as to the fairness and reasonableness of the price and to assure that prices paid reflect the intrinsic value of an item.
2. The Problem. There is a perception that BOA orders do not provide adequate control of costs and result in mismanagement of appropriated funds. This perception stems from what is perceived to be excessive time to definitize orders resulting in transfer of cost-risk to the government and loss of available funds. Audits have focused attention on delays in the definitization process citing large backlogs, apparently high profits relative to diminished risk and loss of obligation authority.
3. The Situation at ASO. For the quarter ending 30 June 1985, ASO reported a total of 4190 orders at an amount of \$2,188,272,000. Of this total, 860 (20.5%) orders for \$956,536,000 (43.7%) were over 180 days. Due to the high volume and dollar value of procurements at ASO in FY 85 (nearly double the dollar value of FY 84), the numbers reported (though the percentage may be smaller) will increase for the period ending 30 September 1985. Aside from whether 180 days is the right criteria for determining overage, (ASO considers that it is not), aggressive action must be taken to reduce the backlog of undefinitized orders and reduce reliance on such orders.
4. ASO Action.
 - a. Stratify the backlog. Action is in process to develop a further breakdown and update of the present backlog by contractor and by administrative phase of definitization (i.e. awaiting proposal, awaiting audit, etc.). Completion is targeted for 18 October 1985.
 - b. Increase delegation. Action is in process to identify those additional definitization actions that, based on a careful review of relevant factors, should be delegated to the appropriate ACO for pricing. Completion is targeted for 18 October 1985.

Subj: INPUT FOR DISCUSSION WITH ASN(S&L) RE UNDEFINITIZED BOA ORDERS

c. Correspond with senior contract officials. Based on the analysis of the backlog (para. 4a.), prepare written correspondence from Director of Purchasing, ASO to appropriate contractor executives identifying problem areas and requesting appropriate action. This is to supplement previous correspondence and to present it to a higher level of contractor management. Such letters will focus on late submittal of proposals, inadequate support of proposals, delays in negotiation, etc. Completion is targeted for 31 October 1985.

d. Direct Discussion by PG-A. Those firms identified in 4a as having the largest volume in backlog of actions and dollars in undefinitized orders, with emphasis on present and historical overage condition, will be visited directly by PG-A or invited to attend such a meeting at ASO to obtain top level contractor commitment to eliminating the backlog of overaged orders. This is a follow-on to an existing program of contractor visitations. Commence follow-on discussions by 1 November 1985.

e. Use of Tiger Team. ASO intends to utilize negotiation teams composed of contracting officers, contract specialists, pricing analysts (ACO) and financial analysts (DCAA) as necessary at selected contractor locations to rapidly negotiate workable unpriced orders with those contractors identified in 4a and as discussed in 4d. Commence negotiation at selected contractors by 15 November 1985.

f. Recommendations for Expedited Business Clearances. ASO will request NAVSUP and ONAS assistance in expediting and consolidating business clearances for actions associated with reducing the undefinitized order backlog. Submit specific request to NAVSUP/ONAS by 31 October 1985.

g. Expand use of Forward-Priced Rate Agreements (FPRA). FPRA expedite the defintization process. Hold discussions with ACO/DCAA at those locations where a current FPRA does not exist and assist as necessary in effecting such an agreement. Also, where applicable, pursue negotiated Article Price Lists as a means to expedite toward pricing of routinely procured items. Commence discussions with ACO/DCAA by 1 November 1985.

h. Reduce reliance on Unpriced Orders. Conduct a review in conjunction with the requirements determination division (WM) to identify those orders which do not require expedited ordering action and thus can be pre-priced. It is recognized that many valid reasons exist to continue use of the unpriced order as a contracting tool. Some of these are listed as follows:

Subj: INPUT FOR DISCUSSION WITH ASN(S&L) RE UNDEFINITIZED BOA ORDERS

1) Improved readiness. Requirements are placed on order and in production/repair much faster than is possible with other contractual instruments with resultant earlier delivery to the Fleet.

2) Minimize inventory investment. PIPELINE is minimized with resultant positive impact on budgeting/funding.

3) SAIP (Spares Acquisition Integrated with Production) savings are achieved. The window of opportunity for placing orders concurrent with production generally cannot be met without the use of undefinitized orders.

4) Improved responsiveness. Urgent requirements generally necessitate use of undefinitized order to authorize immediate contractor action.



DEPARTMENT OF THE NAVY

OFFICE OF THE ASSISTANT SECRETARY

(SHIPBUILDING AND LOGISTICS)

WASHINGTON, DC 20360-5000

NOV 04 1985

MEMORANDUM FOR DISTRIBUTION

SUBJ: UNDEFINITIZED CONTRACTUAL ACTIONS

Ref: (a) FAR 16.703
 (b) DOD FAR Supplement 16.703
 (c) Navy Acquisition Regulation Supplement 43.204

References (a) through (c) establish policy that orders for supplies, equipment and services should be fully definitized prior to issuance. Recent audit reports and reviews identify deficiencies that should serve to reemphasize the importance of pricing spare parts in advance. The primary reasons for issuing undefinitized contracts and orders have included fleet urgency, maintenance of obligation plans and achieving program schedules. From a business standpoint, undefinitized contractual actions do not provide the necessary incentives to achieve cost control. FY 1985 data indicates that the Navy has a backlog of 12,338 undefinitized actions valued at 11.2 billion dollars. The continuing growth of the backlog of undefinitized actions and their age demands aggressive action and the need for additional management attention.

Effective immediately, I am directing the following actions to reverse the negative trends on undefinitized actions including letter contracts, undefinitized change orders and unpriced/ceiling priced orders:

- Systems Commands and Inventory Control Points are to reduce the number of undefinitized actions issued in FY 86 by 20% and the outstanding dollar value by 30% compared to end of FY 85 numbers.
- Existing undefinitized actions should be reviewed to deobligate excess funds.
- Contractor proposals are to be requested and determined sufficient for negotiations prior to issuing any unpriced/ceiling priced order projected in excess of \$1 million dollars. Orders are not to be severed to avoid this requirement. Exceptions must be documented and approved at the Flag/SES level.
- A requirement for contractors to propose and segregate costs by order must be included in each instrument or unpriced/ceiling priced order.
- Provisions for the withholding of progress payments should be negotiated on new contracts, basic ordering agreements and orders where a history of delinquent proposal submissions exist.

- Additional requirements shall not be added to orders which have been placed.
- Unpriced/ceiling priced orders are not to be used for contractor support services or in any case where the requirement is not clearly defined.
- The backlog and age of undefinitized contractual actions should be considered a command key indicator, placing routine management emphasis on the issue.
- Profit rates negotiated in the definitization process must reflect the risk or lack of risk associated with the production status at the time of definitization.

It is important that we reaffirm our policy to price in advance. Advance planning should eliminate the need in many cases to issue undefinitized contractual actions. Your aggressive action and full support are essential if we are to maintain the ability to selectively use undefinitized contractual instruments under appropriate conditions.

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(SHIPBUILDING AND LOGISTICS)
WASHINGTON, DC 20360-5000



FEB 26 1986

MEMORANDUM FOR DISTRIBUTION

Subj: PROGRESS PAYMENTS UNDER UNDEFINITIZED CONTRACTUAL ACTIONS

This memorandum provides additional guidance to my memorandum of 4 Nov 1985 expressing concern that undefinitized contractual actions do not provide the necessary incentives to achieve cost control.

Our review of causes of backlog growth in undefinitized contractual actions indicates that a major contributor to the problem is failure of contractors to submit definitization proposals in accordance with the timeframes set forth in the contract. These delinquencies go to the heart of the ability of the Government to achieve timely contract definitization. The failure to meet this material requirement of the contract occurs partially because the Government funds the performance via the use of progress payments. The contractor reduces his risk by taking longer to definitize the contract, while continuing to perform work.

When the contractor is delinquent in submitting definitization proposals, you should withhold progress payments.

WPC2-20:TW

18 DEC 1985

OP POLICY AND PROCEDURE MEMO# 110

From: OP

Subj: ESTABLISHMENT OF A MINIMUM PROCUREMENT ADMINISTRATIVE
LEADTIME FLOORRef: (a) ASN Memo, Subj: Undefined Contractual Actions dtd 4 Nov 85
(b) WM-A Memo, WM-11:JLW dtd 9 Dec 1985

1. Reference (a) directs a 20% reduction in unpriced BOA (Basic Ordering Agreement) actions and a 30% reduction in the dollar value of unpriced orders by 30 September 1986. This is the first step by SECNAV to enforce firm fixed prices prior to the award of spares orders and other contracts. Since 70% of ASO's obligations have historically consisted of unpriced orders, compliance with the firm fixed price policy will extend administrative leadtimes a minimum of 90 days and as much as 270 days for every sole source buy (60% of our dollars in FY86).
2. As a consequence of the expected ALT (Administrative Leadtime) extension, a mechanized browse was performed in conjunction with December's quarterly levels to ensure a minimum ALT of 3 quarters for all items in the MDF. This was accomplished by setting the procurement leadtime DEN B011A, equal to the production leadtime, DEN B010, plus 3 quarters for all items having less than a 3 quarter difference. Items having ALTs greater than 3 quarters (procurement leadtime larger than production leadtime plus 3 quarters) were bypassed.
3. Item managers performing manual leadtime maintenance are to ensure that a minimum of 3 quarters ALT is reflected. A larger ALT may be assigned when based upon actual experience. Reference (b) previously directed this change.



DEPARTMENT OF THE NAVY

AVIATION SUPPLY OFFICE
700 ROBBINS AVENUE
PHILADELPHIA, PA 19111-5098

IN REPLY REFER TO
WP-01:RBW
22 APR 1986

OPERATIONS POLICY AND PROCEDURE MEMO #145

Subj: APPROVAL LEVELS FOR ISSUANCE OF UNPRICED ORDERS

Ref: (a) PG Unpriced Order Update Briefing of 7 Apr 1986
(b) WM-A Memo WM-11:JLW dtd 4 February 1986
(c) WM-A Memo WM-11:JLW dtd 25 March 1986

1. Reference (a), provided an executive briefing on the progress of making our Unpriced Order (UPO) goal of \$1.9 billion in undefinitized (unpriced) orders. Based on PG's definitization target of \$1.8 billion to \$2.1 billion we have a forecasted \$300 million to \$677 million UPO limitation for the remainder of this fiscal year. This value is in contrast with the estimated \$1.4 billion of requirements awards by PG between 1 April and 30 September 1986 to meet minimum fleet readiness requirements. Conversely, this equates to issuing Firm Fixed Priced (FFP) contracts totalling \$700 million to \$1.1 billion. In order to ensure all three execution goals are met (i.e., \$1.9 billion 30 September 1986 UPO balance, 40% Competitive awards, \$3.6 billion requirements execution awards) intensified management is required at all levels. Accordingly, progress toward each goal will continue to be reported at the weekly Requirements Execution Board (REB) and the following morning's Executive Board Meeting.

2. WM shall prioritize the unawarded BOA PRs as follows:

- a. FY86 ROR orders.
- b. PRs greater than \$100K with a projected stock-out or site stand-up within 12 months (CO UPO approval required over \$1 Million, WM approval required less than \$1 Million).
- c. PRs greater than \$100K with a projected stock-out or site stand-up within 18 months (approval same as 2.b.above).
- d. Emergency PRs between \$25K and \$100K as occurring and approved by WM-A.
- e. PRs not included above.

3. WM shall take action to code the DSF to indicate those PRs which have been approved for release as UPO. The total value of categories a through d above shall not exceed \$300 million without approval of the REB.



Subj: PROCESSING OF UNPRICED ORDERS

4. WP shall control the remaining \$200 million UPO balance as follows:

a. GFE BOA UPO required to meet production schedules (OP approval required up to \$1 million, CO approval over \$1 million) using similar procedures established by reference (b) and (c).

b. Urgent FMS and PTD BOA UPO with OP approval up to \$1 million and CO approval over \$1 million. WS shall forward requirements via WP-01 using similar procedures established by reference (b) and (c).

5. PG has agreed to:

a. Report the value of undefinitized orders remaining at the end of each month.

b. Release UPO up to \$100 million less than the amount of definitizations each month between 1 April and 31 August 1986 based on the target definitizations by month (column (b)). PG will control the issuance as follows:

	(a) Beginning UPO <u>Balance</u>	(b) 1 Apr to 30 Sep Target <u>Definitization</u>	(c) Planned UPO <u>Issues</u>	(d) Projected UPO EOM <u>Balance</u>
April	\$2.6B	\$200M	\$100M	\$2.5B
May	\$2.5B	\$200M	\$100M	\$2.4B
June	\$2.4B	\$200M	\$100M	\$2.3B
July	\$2.3B	\$200M	\$100M	\$2.2B
August	\$2.2B	\$200M	\$100M	\$2.1B
September	\$2.1B	\$200M	-0-	\$1.9B
Total		<u>\$1,200M</u>	<u>\$500M</u>	

6. The above targets include all orders placed by PG since 1 April regardless of the month reported in the financial records.

99TH CONGRESS
2D SESSION

H. R. 4461

To amend title 10, United States Code, to impose limitations on the obligation and expenditure of funds and the making of progress payments by the Department of Defense with respect to so-called undefinitized contractual actions.

IN THE HOUSE OF REPRESENTATIVES

MARCH 20, 1986

Mr. WYDEN (for himself, Mr. BRYANT, Mr. SIKORSKI, and Mrs. BOXER) introduced the following bill; which was referred to the Committee on Armed Services

A BILL

To amend title 10, United States Code, to impose limitations on the obligation and expenditure of funds and the making of progress payments by the Department of Defense with respect to so-called undefinitized contractual actions.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as The Unpriced Military Con-
4 tracts Reduction Act of 1986.

1 SECTION 1. LIMITATION ON USE OF FUNDS BY THE DEPART-
2 MENT OF DEFENSE FOR UNDEFINITIZED CON-
3 TRACTUAL ACTIONS.

4 (a) IN GENERAL.—For fiscal years 1987, 1988, and
5 1989, the total amount of funds appropriated or otherwise
6 made available to the Department of Defense that is obligat-
7 ed or expended by the Secretary of Defense and the Secre-
8 taries of the military departments with respect to undefini-
9 tized contractual actions may not exceed—

10 (1) with respect to fiscal year 1987, 10 percent of
11 the amount of funds appropriated or otherwise made
12 available to the Department of Defense for procure-
13 ment for that fiscal year; and

(2) with respect to each of fiscal years 1988 and 1989, 5 percent of the amount of funds appropriated or otherwise made available to that Department for procurement for that fiscal year.

(b) DEFINITION.—In this section “undefinitized contractual action” has the meaning given such term in section 2325(c) of title 10, United States Code (as added by section 2(a)(1)).

22 SEC. 2. RESTRICTIONS ON UNDEFINITIZED CONTRACTUAL AC-
23 TIONS OF THE DEPARTMENT OF DEFENSE.

(a) IN GENERAL.—(1) Chapter 137 of title 10, United States Code, is amended by adding at the end thereof the following new section:

1 **“§ 2325. Undefined contractual actions: restrictions**

2 “(a) The head of an agency may not enter into an unde-
3 finitized contractual action unless the contracting officer for
4 the contract justifies the use of such an action in a certificate
5 of urgency. The certificate of urgency shall be included in the
6 file on the contract and shall include the following:

7 “(1) The date on which performance under the
8 contractual action is required to be completed.

9 “(2) An estimate of the damage that will be in-
10 curred by the United States if the performance is not
11 completed on or before that date.

12 “(3) The date on which the need for such per-
13 formance was first apparent.

14 “(4) If, after the need for such performance was
15 first apparent, there was sufficient time for such per-
16 formance to be acquired through contracting proce-
17 dures other than the use of an undefinitized contractual
18 action, a detailed explanation of the reasons for delay
19 in initiating the acquisition through those contracting
20 procedures.

21 “(5) If, after the need for such performance was
22 first apparent, there was insufficient time for such per-
23 formance to be acquired through contracting proce-
24 dures other than the use of an undefinitized contractual
25 action, a detailed description of the circumstances lead-
26 ing to the problem of insufficient time and of actions

1 that will be taken by the head of the agency to avoid
2 the repetition of such a problem.

3 “(b) The head of an agency may not make any payment
4 for work in progress with respect to an undefinitized contrac-
5 tual action on or after the earlier of—

6 “(1) the date on which 40 percent of the perform-
7 ance required under the contractual action is complete;
8 or

9 “(2) the end of the 180-day period beginning on
10 the date that performance is begun under the contrac-
11 tual action.

12 “(c) In this section, ‘undefinitized contractual action’ is
13 a contractual action entered into by the Secretary of Defense
14 or a Secretary of a military department for which the con-
15 tractual terms, specifications, or price are not definite before
16 performance is begun under the contractual action. Such
17 term includes the following:

18 “(1) Letter contracts or orders.

19 “(2) Provisioned item orders.

20 “(3) Change orders or contract modifications.

21 “(4) Purchase orders.

22 “(5) Basic ordering agreements.

23 “(6) Time and material contracts.

24 “(7) Labor-hour contracts.”.

1 (2) The table of sections at the beginning of such chap-
 2 ter is amended by adding at the end thereof the following
 3 new item:

“2325. Undefinitized contractual actions: restrictions.”.

4 (b) **EFFECTIVE DATES.**—(1) Subsection (a) of section
 5 2325 of title 10, United States Code (as added by subsection
 6 (a)(1)), applies to undefinitized contractual actions that are
 7 entered into after the date of the enactment of this Act.

8 (2) Subsection (b) of such section does not apply to un-
 9 definitized contractual actions—

10 (A) that are entered into before the date of the
 11 enactment of this Act; and

12 (B) under which performance is more than 40 per-
 13 cent complete on such date.

14 (c) **TRANSITION PROVISIONS.**—With respect to an un-
 15 definitized contractual action described in subsection (b)(2),
 16 the head of an agency may not—

17 (1) make any payment for work in progress after
 18 such date; or

19 (2) negotiate a final price for such action that
 20 allows a profit for such action of more than 5 percent
 21 of the final price.

○

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